BEFORE

THE PUBLIC SERVICE COMMISSION OF

SOUTH CAROLINA

DOCKET NO. 2012-218-E - ORDER NO. 2013-41

FEBRUARY 7, 2013

IN RE: Application of South Carolina Electric & Gas Company for Increases and Adjustments in Electric Rate Schedules and Tariffs and Request for Mid-Period Reduction in Base Rates for Fuel	)	ORDER DENYING PETITION FOR REHEARING

This matter comes before the Public Service Commission of South Carolina ("Commission") on the December 31, 2012, Petition for Rehearing ("Petition") of the South Carolina Energy Users Committee ("SCEUC") filed with the Public Service Commission of South Carolina ("Commission") in the above-captioned docket. In the Petition, SCEUC asserts that the Commission's findings and conclusions on several matters contained in Order No. 2012-951 ("Order") are in error. The Petition is without merit and is hereby denied.

I. STANDARD FOR CONSIDERING PETITIONS FOR REHEARING

The purpose of a petition for rehearing is to allow the Commission to identify and correct specific errors and omissions in its orders. Pursuant to S.C. Code Ann. § 58-27-2310 (1976, as amended), "[n]o right of appeal accrues to vacate or set aside, either in whole or in part, an order of the commission . . . unless a petition to the commission for a rehearing is filed and refused . . . ." In the present case, we find no errors or omissions in Order No. 2012-951.

II. ALLEGED ERRORS CONTAINED IN THE ORDER

Order No. 2012-951 is a comprehensive Order setting forth specific findings and conclusions regarding the matters raised in this proceeding, including the arguments of SCEUC. The Order is based on a thorough and comprehensive review and analysis of the facts and evidence presented in the hearing in this matter. After careful review of the Petition, this Commission has determined that the Petition does not raise any issues of law or fact that were omitted from consideration or misconstrued in the prior order. The Commission finds that the preponderance of evidence, the law and sound ratemaking policy support each of the findings and conclusions contained in Order No. 2012-951. However, we will discuss each allegation of error individually in this Order.

A. UNDUE WEIGHT AFFORDED TO THE MEMORANDUM OF UNDERSTANDING

Prior to the hearing in this matter, all of the parties except the SCEUC entered into a comprehensive settlement agreement in the form of a Memorandum of Understanding (the "MOU"). In its Petition, SCEUC criticizes this Commission's decision to accept the MOU as a reasonable basis for resolving the issues presented here. SCEUC cites South Carolina Supreme Court cases that hold that even when the parties to a proceeding are in agreement, the Commission has an independent duty to review all relevant matters before it. *See*, *Hilton Head Plantation Utilities, Inc. v. Pub. Serv. Comm'n*, 312 S.C. 448, 451, 441 S.E. 2d 321, 323 (1994); *Kiawah Prop. Owners Group v. Pub. Serv. Comm'n*, 359 S.C. 105, 597 S.E.2d 145 (2004). SCEUC implies that this Commission did not conduct its own review of the matters at issue here and alleges that this Commission gave the MOU "greater weight than it was due" in reaching a decision in this proceeding. This assertion is simply not accurate.

In adopting Order No. 2012-951, this Commission conducted a thorough review of all the issues raised in this proceeding. This Commission held extensive hearings in this docket and received testimony from 21 individual utility, ratemaking and financial experts and senior utility executives. Their testimony and exhibits cover all aspects of the relief requested in this docket and of the MOU. This Commission also conducted three night hearings to take testimony from members of the public. We carefully considered such public testimony in balancing the interest of the consuming public with that of the utility in reaching the decisions contained in Order No. 2012-951. The resulting record is thorough and extensive.

In Order No. 2012-951, this Commission has entered detailed findings of fact and conclusions of law on all matters presented for consideration in this proceeding. This Commission's review and inquiry in this proceeding was thorough, and our review and inquiry fully meet the legal standards set forth in *Hilton Head Plantation Utilities, Inc.*, *supra*, and *Kiawah Prop. Owners Group, supra.*

Nevertheless, as a matter of regulatory policy, we recognize that settlement agreements among parties to rate proceedings can promote regulatory stability, certainty and predictability – all of which are beneficial to customers, utilities and the State of South Carolina. The Commission finds that parties should be encouraged to reach such agreements. Furthermore, when diverse parties with disparate interests, including the applicant and ORS and others, reach consensus as to what represents a just and reasonable outcome, the Commission can appropriately consider that fact in its deliberations. When consensual agreements are reached between principal parties to a proceeding, such agreements will be given due and careful consideration by the Commission, as has been done here. The signatory parties to the MOU included a broad spectrum of interests. In this case, SCEUC was not a signatory to the agreement. In any event, however, we fully and completely evaluated the evidence, independent of the Memorandum of Understanding in this case, and must reject SCEUC's allegation of error.

B. RATE DIFFERENTIALS

SCEUC raises several key issues related to SCE&G's proposed rate increase. They are return on equity, capital structure, wholesale revenues, incentive pay, and allowable pension expenses. As to each of them, SCEUC proposes that the Commission reverse the decisions made in Order No. 2012-951, based upon an unsupported comparison of SCE&G's retail electric rates with those of other investor-owned utilities in South Carolina and neighboring states. However, SCEUC provides no data specifically comparing SCE&G's equity returns, capital structure, wholesale marketing efforts, incentive pay levels, or pension packages to those of the comparative utilities. SCEUC did not produce evidence that its comparison provided any valid evidence for determining reasonable rates for SCE&G.

The Supreme Court of South Carolina has addressed the circumstances in which the Commission may consider rate comparisons in ratemaking proceedings. The Court has ruled that the Commission may consider the rates of other utilities only where a showing has been made "that those [utilities] are sufficiently similar to the applicant to allow a meaningful comparison." *Utilities Services v. Office of Regulatory Staff*, 392 S.C. 96, 114, 708 S.E.2d 755, 765 (2011) (citing *Heater of Seabrook, Inc. v. Pub. Serv. Comm'n,* 332 S.C. 20, 503 S.E.2d 739 (1998)). "It is improper for the PSC to draw comparisons with other entities without stating its basis for finding the entities sufficiently similar for comparison purposes." *Id.*

As Company witness Byrne testified:

Each utility has legacy generation, transmission and distribution systems that are unique to that utility alone. Utilities have different load factors, and proportions of wholesale, industrial and commercial load. There are differences among utilities in the climates of their service territories and in the geographic concentration or dispersion of their customers and load centers. All these factors affect the cost to serve customers and therefore affect rates.
Tr. at 284

In this case, SCEUC has not presented any evidence that would allow the Commission to conclude that the undifferentiated rate comparisons that SCEUC has presented constitute a reliable basis on which to make decisions concerning equity returns, capital structure, wholesale marketing efforts, incentive pay, or pension packages. To the contrary, through its witness, Mr. Byrne, SCE&G affirmatively showed that the rate differentials that SCEUC relies on are explained by the fact that its neighboring utilities have generation portfolios that include a higher percentage of low-cost nuclear generation, and a larger percentage of low-cost highly-depreciated base load generation than SCE&G.[1] These rate differentials are also explained by the relative

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[1] Specifically, the evidence shows that, during the development and industrialization boom that occurred in this region in the 1960s and 1970s, SCE&G's service territory experienced slower growth than its neighbors who served major

absence of highly concentrated load centers in SCE&G's service territory and the additional expense of building and maintaining the transmission and distribution infrastructure necessary to serve a more dispersed customer base.

In short, SCEUC has not made the comparability showing required by *Utilities Services v. Office of Regulatory Staff, supra*, to demonstrate that the rate differentials between SCE&G and the utilities listed by SCEUC witness Kevin O'Donnell are a relevant consideration for ratemaking purposes. To the contrary, the evidence of record affirmatively shows that these rate differentials are the result of different levels of investment and different cost structures among the utilities and in no way indicate that the rates SCE&G requested in this docket are not just and reasonable or that they reflect imprudently incurred costs.

development centers like the Raleigh-Durham area, the Charlotte-Gastonia area, and the I-85 corridor in upstate South Carolina. As a result, it was unnecessary for SCE&G to construct as much new generation as was required of neighboring utilities during the period. Consequently, SCE&G emerged in the 1980s with less nuclear generation and lower base load generation capacity reserves than its neighbors. Tr. at 290. While this allowed SCE&G to charge low rates compared to its neighbors during the 1980s and 1990s, these utilities now have large blocks of low cost, highly depreciated and highly efficient base load generation much of which is low-cost nuclear generation. Because SCE&G does not currently have access to a similar level of capacity of nuclear generation, analyzing SCE&G's rates in comparison to those of dissimilar utilities by SCEUC is inappropriate and unjustified. In addition, during a 23-year period from 1987-2010 SCE&G was required to invest $1.3 billion in new base load and intermediate generation to meet customers' requirements. During this same period, neighboring investor-owned utilities were not required to make as much investment, thus reducing their relative cost per kilowatt hour. Tr. at 287-288.

C. RETURN ON EQUITY

SCEUC contends that the record does not support the Commission's determination of the appropriate Rate of Return on Equity ("ROE") in this proceeding and that SCE&G's ROE should be set at 10%. Notably, SCEUC witness O'Donnell recommended that the Commission set the Company's ROE at 9.5% in the hearing. Tr. at 914. SCEUC purports to base its new position on the testimony of Dr. Carlisle, who is ORS's economist. SCEUC asserts that "Dr. Carlisle's testimony recommends a 10% return on equity as a baseline under the current market conditions . . . ." Petition at p. 8. However, this assertion is contradicted by the evidence of record. In his sworn testimony, Dr. Carlisle unequivocally recommended the same 10.25% ROE that is reflected in the MOU and adopted by the Commission in Order No. 2012-951:

Q. WHAT ROE DO YOU RECOMMEND?

A. I recommend an ROE of 10.25%.

Tr. at 1176. Nowhere in his testimony does Dr. Carlisle indicate that 10% is his "baseline" recommendation under "current market conditions" as SCEUC suggests. Even more, the record does not reflect that Dr. Carlisle recommended 10% as a suitable ROE for SCE&G under any theory, and SCEUC provides no support for its assertion.

In addition, as set forth in Order No. 2012-951, multiple witnesses, including Dr. Carlisle, Mr. Hevert and Mr. Addison, testified that it is just and reasonable to set rates to allow SCE&G the opportunity to earn a 10.25% ROE. (See Tr. at 1186, 569-570, and 508-509, respectively.) This 10.25% ROE is substantially lower than SCE&G's currently approved ROE, SCE&G's requested ROE and the ROE granted to Duke Energy

Carolinas, LLC in 2011. Based on the evidence of record in this proceeding, this Commission again finds that a 10.25% ROE appropriately balances the interests of customers with the interests of SCE&G and its investors and is a just and reasonable ROE on which to set rates for SCE&G in this case. SCEUC provides no credible evidence that would indicate otherwise, and its allegation of error regarding the rate of return on equity must be rejected.

D. SCE&G CAPITAL STRUCTURE

SCEUC argues that, in calculating SCE&G's allowable rate of return on rate base, the Commission erred in using SCE&G's capital structure rather than that of SCANA, SCE&G's parent company. This argument is based on the "double leveraging" theory advanced by SCEUC's witness O'Donnell. However, as articulated in Order No. 2012-951, the Commission found that SCANA's different business risks, credit profile and financial position made it inappropriate to use SCANA's capital structure in computing SCE&G's cost of capital. Nothing presented in the SCEUC Petition convinces this Commission that we erred in our initial ruling.

In setting rates, a rate of return is calculated based on the a) utility's cost of debt, b) utility's cost of equity, and c) proportion of each within the utility's capital structure. This rate of return is applied to the utility's rate base (*i.e.*, its net investment in utility assets), to calculate the revenue that rates must generate to recover the reasonable cost of the capital that the utility has invested in its operations.

For the results of the rate of return calculation to be meaningful, all three factors - cost of debt, cost of equity and capital structure- must be determined on a consistent basis. In this regard, SCEUC witness O'Donnell's proposal is flawed through its inconsistent application and by mixing and matching between SCANA factors and SCE&G factors in a way that creates distorted results.

The cost of debt used by Mr. O'Donnell, Mr. Hevert and Dr. Carlisle in their rate of return calculation was SCE&G's actual cost of debt. SCE&G's actual cost of debt is quite low because of, among other reasons, the relatively high percentage of equity in SCE&G's capital structure.[2] On the other hand, SCANA's capital structure is more highly leveraged and would not support SCE&G's low cost of debt.

Similarly, Mr. Hevert, Mr. O'Donnell and Dr. Carlisle all sought to measure SCE&G's cost of equity based on SCE&G's business risks, creditworthiness and financial profile. SCE&G is a regulated electric generation, transmission, and distribution company. SCANA, on the other hand, operates a major gas distribution business in North Carolina, a major unregulated retail gas marketing company in Georgia, unregulated wholesale and industrial gas marketing operations throughout the Southeast, and a FERC regulated interstate gas transmission company. As Mr. Hevert testified, in the context of SCANA's overall portfolio of businesses, its revenues from electric operations are insufficient to meet the objective screening criteria for selecting companies with business risks comparable to those of SCE&G's electric operations. Tr. at 583. Further, as Mr. Hevert showed in his rebuttal testimony, SCE&G's capital structure closely matches the capital structure of the firms that both he and Mr.

[2] This higher percentage of equity means that bond holders' payment rights are more secure since more of the firm's capital is in the form of equity, whose holders are at risk of not being paid if returns are insufficient to generate earnings and dividends for them.

O'Donnell chose as comparable companies to use in measuring the cost of equity capital for SCE&G. SCANA's capital structure does not. Tr. 670-672.

SCANA's business profile is quite different from that of SCE&G. For this reason, it is inappropriate to use SCANA's capital structure in determining SCE&G's rates. Mixing and matching cost of debt, cost of equity and capital structure between the two entities is factually unwarranted and would inject inaccuracy into the computation of a reasonable return for SCE&G.

On the other hand, contrary to what is alleged in the Petition, setting rates of return on an internally consistent and methodically sound basis ensures that the results reached are fair and equitable to all parties, and no party is prejudiced. By using SCE&G's cost of debt, cost of equity and capital structure, the resulting rate of return reflects the risks and requirements for investing in a company of SCE&G's capital structure and business risks. SCE&G's customers pay precisely the rate of return necessary to support a company of its financial profile operating in the electric business. To the extent that SCANA has different business risks, a different credit profile and different financial structures from SCE&G, they will be reflected in the cost of capital for that company and will not affect SCE&G's electric customers.

E. REVENUE LOSS ASSOCIATED WITH TERMINATED WHOLESALE POWER CONTRACT

SCEUC argues that SCE&G should be "given some incentive to market its excess [wholesale] capacity," and suggests penalizing SCE&G by reducing its revenue requirement in this case by $9.6 million to do so. Petition at 16. However, the uncontroverted evidence of record is that SCE&G does not have any "excess [wholesale] capacity" to market. Tr. at 761. Customer growth and the need to retire older coal units for environmental reasons have put SCE&G in the position where it does not have firm wholesale capacity to sell. Moreover, as SCE&G's witness Mr. Harris has testified, without contradiction, the smaller municipal customers in the region, who are the customer group that Mr. O'Donnell believes should buy this capacity, will not be in the market for additional capacity for five years. Tr. at 759-760. Given the lack of capacity to sell and the absence of ready buyers in the market, creating a $9.6 million dollar "incentive" for SCE&G to market capacity in the form of a penalty against revenue requirements would be unreasonable and confiscatory.

Furthermore, the Petition mischaracterizes Mr. Harris's testimony when it states that he testified that "SCE&G's effort to market the excess capacity was limited to its monitoring efforts." Petition at 15. In fact, Mr. Harris testified that SCE&G proactively markets power to customers and actively seeks out opportunities wherever they exist. Tr. at 763-765.

In addition, the Company's current Integrated Resource Plan shows that even after the 250 MW contract expires, SCE&G's capacity margin will be at the lower end of SCE&G's target reserve range until the second of the new V.C. Summer nuclear units comes on line. Accordingly, SCEUC's allegation with regard to the terminated wholesale power contract is without merit.

F. EMPLOYEE INCENTIVE PAY

SCEUC urges the Commission to exclude from rates 100% of SCE&G's incentive pay for its employees in the interest of "equity and fairness." Petition at 17. In previous dockets, the Commission approved the inclusion of 50% of incentive pay in rates finding that this level of inclusion resulted in a "reasonable pay package" for SCE&G. *See*, Order 1996-15. In a later proceeding, the Commission ruled that a "50/50 sharing between shareholders and ratepayers of the costs for employee and executive bonuses creates a reasonable incentive to create ratepayer benefit." *See*, Order No. 2005-2. We followed this reasoning again as recently as the 2011 electric rate order for Duke Energy Carolinas, LLC.[3] Other states have also permitted a portion of costs related to incentive pay to be included in rates where the incentives are designed to achieve operational goals or achieve other benefits accruing to rate payers, which SCE&G's incentives do.[4] The Commission believes that this approach is still just and reasonable from the evidence presented in the present proceeding. The Company presented testimony that incentive pay is necessary for recruiting qualified employees and to encourage SCE&G's employees to excel. Tr. 706-708. SCEUC has not provided any

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[3] *See*, Order No. 2012-77, entered in Docket No. 2011-271-E (implementing a settlement agreement in which the parties agreed "to accept all proposals and recommendations put forth in ORS's testimony"); Pre-Filed Direct Testimony of ORS Witness Leigh C. Ford in Docket No. 2011-271-E, p.4, ll.13-14 (stating in pertinent part that "ORS proposes removing 50% of the variable pay as it was driven by earnings per share").

[4] *In re Michigan Consol. Gas Co.*, U-13898, 2005 WL 1159407 (Apr. 28, 2005) *order corrected,* U-13898, 2005 WL 1677913 (May 24, 2005); *In re PacifiCorp*, 97-035-01, 1999 WL 218118 (Mar. 4, 1999) *order clarified on reconsideration sub nom. In re PacifiCorp.*, 97-035-01, 1999 WL 547983 (Apr. 13, 1999) and *on reh'g,* 97-035-01, 1999 WL 1531528 (Dec. 13, 2099); 2006 WL 1348489 (Ky.P.S.C.), 2.

convincing evidence that this methodology should be changed in any way, and SCEUC's allegation of error must be rejected.

G. PENSION DEFERRAL IN RATE BASE

SCEUC asserts that the Commission erroneously allowed the Company to include pension expense related to its defined benefit pension plan in rates and ignored uncontroverted evidence in the record that defined benefit plans are no longer appropriate. This is not the case. The factual record shows that defined benefit plans are offered by the utilities and other entities with whom SCE&G competes in recruiting and retaining employees and are an important part of SCE&G's overall compensation. Tr. 711-712. This allegation of error is also without merit.

H. MID-PERIOD REDUCTION IN BASE RATES FOR FUEL

In the Application in this matter, SCE&G proposed a mid-period fuel factor adjustment. Doing so would accelerate the reduction in SCE&G's fuel factor which could be justified based on lower natural gas prices. Current fuel factors had been set in the 2012 fuel proceeding. They were set at a level sufficient to zero out the unrecovered balance in the fuel accounts by April 2013. *See* Order No. 2012-295.

In this proceeding, SCE&G proposed to accelerate the reduction in the fuel factor even though it anticipated carrying an uncollected balance of $24 million in the account on December 31, 2012. Absent SCE&G's proposal to accelerate the fuel cost reduction, the fuel cost statute would have allowed SCE&G to continue recovering its fuel costs at the higher level until the last billing cycle in April 2013. This would have allowed the balance to be recovered sooner and with less financial risk to SCE&G.

In agreeing to accelerate the fuel factor reduction, SCE&G sought to protect itself against the possibility that the balance would be more than anticipated on December 31, 2012. (The new electric rates became effective for electric service rendered on or after January 1, 2013. *See* Order 2012-951 at 59.) The MOU parties agreed that SCE&G should be allowed to recover carrying costs equal to the 3-Year Treasury Note rate plus 0.65% on balances in excess of $24 million. This agreement is reflected in the terms of Order No. 2012-951. *See* Order at 58 and Order Exhibit No. 1 at 2.

Recent increases in the cost of natural gas have resulted in the under collected balance in the fuel factor accounts being recovered more slowly than anticipated. The balance as of December 31, 2012, was anticipated to be higher than $24 million. Tr. at 741-742; 874-875. Based on testimony to that effect at the hearing, SCEUC argues that SCE&G should not be allowed to recover carrying costs on balances between $24 million and the actual balance in the account on December 31, 2012.

There is no basis in fact or regulatory policy for this position. First, the testimony also showed that, even though the under collection may be higher than $24 million at the time of the proposal, it was and is impossible to predict with certainty where the level of under (or over) collection of fuel costs will be at any certain time in the future, considering all the factors that are a part of the determination of the level of fuel costs collected. Tr. at 874-877. Further, accelerating the fuel factor reduction meant that the Company would be required to bear the financing costs of the unrecovered balance for a longer period than would otherwise be the case. As the Application reflects, the Company was willing to do so, but only if it could cap its risk by being able to recover carrying costs on any amounts in excess of the balance projected at the time it proposed this arrangement. Moreover, the acceleration of the fuel adjustment was a voluntary proposal to benefit customers at the Company's expense. It was not one that the Company was required to make by law or policy.

The Commission finds that it is just and reasonable to accept the Company's proposal as to the mid-period adjustment as made, including the carrying costs. The mid-period adjustment is a voluntary undertaking to assist customers. It is just and reasonable for the Company to cap the financing costs it might incur under this proposal at the levels anticipated when the proposal was made. It is not just and reasonable to impose additional costs on the Company after the fact as SCEUC suggests.

III. CONCLUSION

For the foregoing reasons, this Commission denies the relief sought by the South Carolina Energy Users Committee in their Petition for Rehearing in its entirety.

This Order shall remain in full force and effect until further order of the Commission.

BY ORDER OF THE COMMISSION:

David A. Wright, Chairman

ATTEST:

Randy Mitchell, Vice Chairman

(SEAL)